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C O N F I D E N T I A L SECTION 01 OF 03 VIENTIANE 000612

SIPDIS

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TAGS: [EMIN](#) [ETRD](#) [PHUM](#) [PREL](#) [BM](#) [LA](#)
SUBJECT: THE LAO SAPPHIRE INDUSTRY IN A NUTSHELL

REF: 00 VIENTIANE 1498

Classified By: CDA Peter Haymond for reasons 1.4 (b) and (d)

¶1. (SBU) SUMMARY: Although Laos has significant gem resources, its sapphire industry remains paralyzed by a lack of capital and the technological expertise needed to develop it. A cumbersome bureaucracy and worries about corruption cause many foreign companies to avoid investing in long-term project development. Since 2000 the Government of Laos (GOL) has tried unsuccessfully to balance its drive to monopolize the industry with its attempt to attract the foreign investment necessary to develop it. This has led to a cessation in local mining, and in the last four years, there has been no significant sapphire mining in Laos. Embassy research indicates that approximately fifty percent of the sapphires sold as Lao come from abroad, including Thailand, Cambodia, Sri Lanka, and Burma. The GOL's inability to exploit its sapphire resources is not unlike its inability to promulgate a new mining law -- Laos needs the revenues, it has the resources, but the GOL's fear of being cheated by foreigners leads it to delay and revisit decisions in a seemingly never-ending quest to find the perfect solution and the perfect deal.
END SUMMARY

BACKGROUND

¶3. (SBU) International investors took interest in Lao sapphires in the 1980's, after stories of local farmers finding large gem stones on their properties began reaching Thai gem traders. An initial wave of Thai and Russian mining companies invested in sapphire mining in Bokeo province (literally "gem mine province") but were not successful in developing long-term projects. In 1994, the Gems Mining Company was created by Australian investors in Bokeo. The company received concessions for sapphire mining at five sites in Houyay District and conducted geological surveys for all of them. Gems Mining was able to conduct extraction only on two sites before the GOL suspended its operations in 1999. Ref A provides some background on the case, which became mildly famous thanks to a book ("Nightmare in Laos") written by an Australian woman, Kay Danes, imprisoned with her husband by the Lao in connection with the seizure of the company.

¶4. (SBU) The controversial takeover of the Gems Mining Company by the GOL in 2000 was seen by many as a low point in the Lao openness to foreign investment. The GOL charged the managers of the company with fraud, confiscated all their assets, and nationalized the company. For the next six years, the company failed to make any profits and was eventually transformed into the Lao Sapphire Company. The Lao Sapphire company remains under Lao management but

dependent on capital investment from a new majority shareholder from Hong Kong.

THE LAO SAPPHIRE INDUSTRY TODAY

15. (SBU) Most sapphires in Laos are found in the Houyay District of Bokeo Province bordering Thailand and Burma. Bokeo sapphires are considered to be of a superior quality, famous for their strength and deep blue color. Limited sapphire resources also exist in Houaphanh and Attapu Provinces. The Department of Geology at the Ministry of Energy and Mines currently estimates that Laos has enough sapphire resources for nine to ten years of full-time mining, although a modern survey of possible resources is yet to occur.

16. (C) Despite great potential, the Lao sapphire industry remains paralyzed by a lack of capital and the technological expertise necessary for modern gem mining operations. An estimated upfront investment of five million dollars is needed in order to start a sapphire mining company. In addition, investors must finance reconnaissance surveys, compensation for farmers, and operational costs, including salaries and entertainment expenses for government overseers, who monitor each step of the mining operations. A member of the Lao Sapphire Company told us it was de rigueur to provide visiting officials (male) with whiskey and attractive young women when they visited the company's offices in Bokeo. According to Embassy research, perceived governmental corruption remains a significant disincentive for foreigners interested in tapping Laos' gem resources.

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LACK OF STANDARD MINING CONCESSION AGREEMENT INVITES CORRUPTION

17. (C) The 1997 Mining Law regulates the management and exploitation of minerals, starting from prospecting and a basic geological survey of natural resources to mineral extraction and the processing of minerals in Laos. Strict rules about concession agreements between the mining companies and the government, and the need to individually negotiate each concession agreement, created an environment in which bribes are often the only way to receive the government's approval for each phase of mining operations. The president of the Bokeo Mining Company said that at least a five percent cut of the estimated profit on future mining operations is expected to be paid to the government officials granting concessions agreements. Overall, the Mining Law, as described by the Deputy Director of the Geology Department at the Ministry of Energy and Mines, is outdated and inadequate for the new business environment. The Lao National Assembly is expected to revise it by the end of 2008. A number of serious foreign mining ventures in Laos, including the Australian firms Oz Minerals and Phu Bia Mining, are advising the government and hope to see an improved law to improve Laos' international competitiveness and increase transparency in negotiating concession agreements.

18. (SBU) The GOL tries to balance its drive to remain in control over all aspects of the sapphire industry with a dire need to attract the foreign investment necessary to develop it. At this time, the central government controls all aspects of the industry. Vientiane has a total monopoly over the decision-making process and safeguards all investment opportunities in Bokeo sapphire mining. Sapphire mining is not included in the province's economic plan, which focuses instead on hydroelectricity and tourism as the main sources of income. Provincial government officials are excluded from decision-making and have very limited knowledge about the current state of sapphire mining in their province.

¶9. (SBU) At the present, only three companies have government's concessions for sapphire mining in Laos:
--The Lao Sapphire Company (a Lao-Chinese venture, the former Australian-owned Gems Mining Company)
--The Bokeo Mining Company (Lao private business operating in partnership with the Bohae Mining Company)
--The Bohae Mining Company (since August 2008 a Lao-Australian partnership, a former Lao-Korean venture)

¶10. (SBU) In 2006, the GOL suspended the extraction operations of all three companies citing unresolved disputes over compensation to local farmers. According to government regulations, the companies are responsible for reimbursements to local farmers for lost income from the land being used for sapphire extraction. The companies cannot resume extraction work until all compensation is paid and the land that was previously exploited is restored to its pre-mining farming condition. In December 2008 the government is expected to reevaluate future exploration and extraction approvals for all three companies.

¶11. (SBU) In the last couple of years, the GOL has relied on capital from China and Vietnam to conduct basic geological surveys and develop the sapphire industry. While processing and trading are still dominated by the Thais, and prospecting and exploration are becoming a field of the Chinese and the Vietnamese, Western companies, due to their technological expertise and skilled labor, still maintain a comparative advantage in extraction and initial processing. In fact, in a surprise recent development, Australian investors have replaced the Korean shareholders of Bohae Mining Company. Embassy contacts, however, remain skeptical about the GOL's willingness to liberalize the investment climate and allow Western companies to compete with Chinese and Vietnamese investors.

COMMENT

¶12. (SBU) At present, there is no sapphire mining in Laos. While the gem sellers in Vientiane and in Bokeo Province advertise their sapphires as Lao, several embassy sources, including the president of the Lao Gems and Jewelry Traders Association, estimate that forty five to fifty percent of

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the sapphires sold in Laos come from Thailand (Kanchanaburi Province), Cambodia, Sri Lanka, and Burma.

¶13. (C) The travails of the Lao sapphire industry are a reminder that doing business in Laos is not for the faint of heart. Although the investment climate is improving, and the GOL is making a concentrated effort to ease red tape, sectors such as mining remain fraught with risk. In expanding the mining sector in Laos and attempting to modernize its governance, the GOL appears to have become almost paralyzed by fear. Fear that its resources will be greedily exploited by foreign investors and fear that a failure to embrace mining could lead to the potential loss of hundreds of millions of dollars in tax revenue desperately needed by the government. It also appears that much of this fear centers on Western-owned mines, which in Laos are the largest and most productive. (Oz Minerals' Sepon mine paid taxes representing about 15% of the entire Lao government budget for 2008.) Chinese and Vietnamese investors continue to receive licenses despite a supposed moratorium on new mining concessions, but have yet to develop world-class mines. If the recent boom in commodity prices turns into another long bust, the GOL may soon rue its inability to fashion a modern, fair, and transparent mining regime attractive to socially-responsible mining concerns. End Comment.

HAYMOND